

# **Auditor's report**

Emakhazeni Local Municipality

30 June 2015

# **Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Emakhazeni Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I have audited the financial statements of the Emakhazeni Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), the Companies Act of South Africa, 2008 (Act No. 71 of 2008) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### **Basis for disclaimer of opinion**

#### **Revenue from exchange transactions**

4. In terms GRAP 23, *Revenue from exchange transaction*, the municipality is required to recognise revenue from the rendering of service when it can be estimated reliably. Contrary to this requirement some meter readings performed during the current year, relating to electricity and water were not captured on the billing system, while some were not captured accurately. This resulted in misstatements of R22 253 058 and R8 412 622 to revenue from sale of electricity and water respectively. Consequently service charges stated at R63 276 919 (2013-14: R64 889 931) in the statement of financial performance and receivable from exchange transaction stated at R 77 784 442 (2013-14: R23 749

429) in the statement of financial position are misstated. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus.

5. The municipality did not charge interest on long-overdue debts as per their policy. I was unable to determine the amount of interest to be charged on long-outstanding debts by alternative means. Consequently interest received revenue and receivable from exchange transactions stated at R 77 784 442 (2013-14: R23 749 429) in the statement of financial position are misstated. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus.

## Revenue from non-exchange transactions

6. The municipality did not bill some of the property owners included on the valuation roll and did not include all the properties that had been improved on the valuation roll. Furthermore, incorrect rates were used in calculating the property rates revenue. I was unable to determine the extent of this misstatement, as it was impracticable to do so. Consequently property rate revenue stated at R16 928 257 (2013-14: R32 072 145) in the statement of financial performance and receivable from non-exchange transaction stated at R3 999 128 (2013-14: R11 315 637) are misstated. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus.

## Property plant and equipment

7. In terms of GRAP 17 *Property, plant and equipment*, an entity shall recognise items of property, plant and equipment that qualify for recognition as assets in the financial statements. Contrary to this requirement, selected assets still in use could not be traced to the fixed asset register. I was unable to quantify the extent of this misstatement, as it was impracticable to do so.
8. I was unable to obtain sufficient appropriate evidence to support the value of assets included in property, plant and equipment due to the non-submission of information. I was unable to confirm this by alternative means. Furthermore, the municipality restated the corresponding figure for their property, plant and equipment by R628 927 264. This restatement could not be supported by appropriate evidence. I was not able to determine the correctness of the restatement by alternative means, as the municipality's systems did not permit the application of alternative procedures.
9. Consequently, I was unable to determine whether any adjustment was necessary to the corresponding figure for assets of R601 551 545 (2013-14: R621 261 077) disclosed in note 4 to the financial statements.

## Provisions

10. I was unable to obtain sufficient appropriate audit evidence regarding adjustments made to prior year provisions amounting to R8 165 614, as the municipality did not provide supporting documentation in this regard. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary relating to provisions amounting to R38 642 585 disclosed in note 13 to the financial statements.

## Cash flow statement

11. The municipality incorrectly calculated the receipts from sale of goods and services resulting in a difference of R32 323 924. Consequently, the cash from operating activities stated at R17 131 346 is misstated.

## Commitments

12. I was unable to obtain sufficient appropriate audit evidence regarding commitments, as the municipality did not provide documentation to support the commitments amount. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary relating to commitments amounting to R12 428 691 disclosed in note 36 to the financial statements.

## Irregular expenditure

13. In terms of section 125 of the MFMA, the notes to the financial statements of a municipality must include any material irregular expenditure incurred during the current year. Contrary to this requirement, irregular expenditure amounting to R14 269 007 was not disclosed in the financial statements of the municipality. Consequently, the irregular expenditure amounting to R7 453 352 disclosed in note 43 to the financial statements is understated.

## Debt impairment

14. In terms of GRAP 104, financial instrument, an entity is required to assess individually significant financial assets for impairment where they are indicators of impairment and collectively assess insignificant financial assets with group of assets with similar credit characteristics. Contrary to this requirement the municipality applied similar rate of impairment for their debtors regardless of their credit characteristics. I was unable to obtain sufficient appropriate audit evidence to support whether the debt impairment was calculated in terms of GRAP 104, as the municipality was unable to provide supporting documents in this regard. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary relating to debt impairment amounting to R32 363 924 (2013-14: -R 31 304 359) disclosed in note 27 to the financial statements.

## Disclaimer of opinion

15. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

## Emphasis of matters

16. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## Restatement of corresponding figures

17. As disclosed in note 39 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of an error discovered during 2014-15 in the financial statements of the municipality at, and for the year ended, 30 June 2014.

## Material impairments

18. As disclosed in notes 9 and 10 to the financial statements, the receivables balance was significantly impaired. The impairment of consumer debtors amounted to R58 048 57 (2013-14: R90 456 581), which represented 42% (2013-14: 73%) of total debtors. The contribution to the provision for debt impairment was R32 408 424 (2013-14: R31 225 458).

## Additional matters

19. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## Unaudited disclosure notes

20. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. These disclosure requirements included under notes 24 and 25 did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

## Unaudited supplementary schedules

21. The supplementary information set out on pages ... to ... does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

## Report on other legal and regulatory requirements

22. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## Predetermined objectives

23. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2015:

- Development priority 1: service delivery and infrastructure development, on pages ... to ...

24. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

25. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priority. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
26. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
27. The material findings in respect of the selected development priority are as follows:

## **Service delivery and infrastructure development**

### Usefulness of reported performance information

28. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 25% of the reported targets were not consistent with those in the approved annual performance, integrated development and service delivery and budget implementation plans. This was due to a lack of monitoring and review by management.
29. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. Significantly important indicators and targets in relation to service delivery were not verifiable. This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes.

### Reliability of reported performance information

30. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was because the municipality could not provide sufficient appropriate evidence in support of the reported performance information and their records not permitting the application of alternative audit procedures.

## **Additional matter**

31. I draw attention to the following matter:

### Achievement of planned targets

32. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priority reported in paragraphs 29 to 31 of this report.

## **Compliance with legislation**

33. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## **Strategic planning and performance management**

34. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.

## **Annual financial statements, performance report and annual report**

35. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not subsequently be provided, which resulted in the financial statements receiving a disclaimer of audit opinion.

## **Procurement and contract management**

36. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, contrary to supply chain management (SCM) regulation 17(a) and (c).
37. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, contrary to SCM regulation 29(5)(b).
38. Contracts were awarded to bidders that did not score the highest points in the evaluation process, contrary to section 2(1)(f) of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) (PPPFA).
39. Contracts were awarded to bidders based on preference points that had not been allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
40. Contracts were extended without tabling the reasons for the proposed amendment in the council of the municipality, contrary to section 116(3) of the MFMA.
41. Persons in the service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).

## **Human resource management**

42. The manager: Technical Services, manager: Planning and Development, and manager: Corporate Services were appointed without having met the prescribed minimum competency levels, contrary to section 54A(2) of the MSA.



## **Expenditure management**

- 43. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
- 44. Reasonable steps were not taken to prevent irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Revenue management**

- 45. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

## **Asset management**

- 46. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

## **Internal control**

- 47. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

## **Leadership**

- 48. Although the accounting officer exercised some oversight responsibility regarding financial and performance reporting, compliance and related internal controls, the financial statements and annual performance report submitted for auditing contained material misstatements. Furthermore, the developed action plan was not adhered to and areas of concern were not addressed as required.

## **Financial and performance management**

- 49. Controls over daily and monthly processing and reconciliations were not implemented, resulting in inaccurate and incomplete financial statements and a performance report that were not supported by reliable supporting information.

## **Governance**

- 50. The internal audit unit and the audit committee operated effectively during the current period as per their legislated mandate. Recommendations were made to management on improvements to the internal controls to ensure reliable reporting of both financial and performance information as well as compliance with legislation. However, this did not result in an improvement in the controls due to management not implementing the recommendations, which led to my adverse assessment of the impact of this unit and committee.

*Auditor-General*

Mbombela

17 December 2015



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